

Internal Revenue Service

memorandum

CC:TL-N-9644-89

Br4:CRGilbert

date: SEP 12 1989

to: Regional Counsel, Southeast Region CC:SE

from: Assistant Chief Counsel CC:TL
(Tax Litigation)

subject: [REDACTED]

This responds to your August 28, 1989 memorandum which requests tax litigation advice regarding the above-styled case. At issue is whether underpayment interest accrues from [REDACTED] (return due date), or [REDACTED] (date of refund of estimated tax payments) for this particular taxpayer. You conclude that since the Government had use of the estimated tax payments from [REDACTED], until [REDACTED], interest runs from the later date. The Service Center's position is that interest accrues from the earlier date. We believe that interest accrues from [REDACTED].

ISSUE

Whether interest on an underpayment shown on a return filed [REDACTED], pursuant to an extension to file, accrues from the taxpayer's return due date, [REDACTED] or from the later date on which estimated tax was refunded, [REDACTED].

FACTS

The taxpayer paid estimated tax of \$ [REDACTED] for its [REDACTED] tax year. On [REDACTED], the taxpayer filed a Form 7004 extending its tax year return due date to [REDACTED]. The form reflected a tax owing of \$ [REDACTED], and the taxpayer applied for a quick refund of estimated tax for the \$ [REDACTED] difference. The Service Center made the requested quick refund on [REDACTED].

On [REDACTED], the taxpayer filed a return reflecting a \$ [REDACTED] tax liability and a \$ [REDACTED] estimated tax penalty. The amount of \$ [REDACTED] was paid with the return.

On [REDACTED] a tax due bill was sent to the taxpayer. The bill included interest on the \$ [REDACTED] underpayment from the [REDACTED] due date of the return to

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the [REDACTED] payment date. On [REDACTED] the Service Center sent the taxpayer an additional bill which also included interest on the interest from [REDACTED] to [REDACTED]. In response, the taxpayer's CPA sent a letter to the Service Center proposing that interest did not begin accruing until [REDACTED] (the date of the \$ [REDACTED] estimated tax refund).

ANALYSIS

We agree with the analysis in your tax litigation advice request. As you note, I.R.C. § 6425(b)(4) provides that any adjustment of estimated tax pursuant to I.R.C. § 6425 shall be treated as a reduction of estimated tax made on the day the credit is allowed or the refund is paid. See also Treas. Reg. §§ 1.6425-3 and 1.6425-2(b). Additionally, I.R.C. § 6655(h) provides that an addition to tax is imposed on an excessive adjustment under I.R.C. § 6425 made before the 15th day of the third month following the end of the tax year. This addition runs from the date of the credit/refund until the 15th day of the third month. Regarding additions resulting from estimated tax underpayments, see I.R.C. §§ 6655(a) through (f); Treas. Reg. §§ 301.6425-3(f)(1) and 1.6655-6(6).

These Code and regulation sections support the view that paid estimated tax may not be disregarded for interest purposes. That is, in a situation such as this, interest accrues from the refund/credit date of the adjustment, or, in other words, from the date the estimated tax became "unpaid."

Rev. Rul. 88-98, 1988-2 C.B. 356, addresses the computation of underpayment interest in four situations where a deficiency has been determined after the taxpayer has timely filed a return reflecting an overpayment, and the overpayment has either been refunded without interest or credited to an installment of estimated tax for the next tax year. As you note, the ruling clearly provides that interest under I.R.C. § 6601(a), in the absence of statutory or regulatory indication to the contrary, accrues from the point that the tax is both due and unpaid.

In taking a contrary position, the Service Center attempts to distinguish the revenue ruling. The Service Center asserts that the ruling is applicable only to interest due on a subsequently determined deficiency where the taxpayer's timely filed return reflected an overpayment that was either refunded without interest or credited to an installment of estimated tax for the next year. Here, an underpayment, as opposed to an overpayment, was reflected on the taxpayer's return; however, we do not believe that this fact alone is sufficient to distinguish the ruling.

The Service Center's position conflicts with the "use of money" principle accepted by the Service in regard to the application of interest. Although this case is not identical to the any of the fact patterns discussed in the revenue ruling, the Service may not artificially treat the taxpayer as underpaid for interest purposes for a period in which the taxpayer was not actually underpaid. Substantial litigating hazards would exist regarding the Service Center's position; it is clearly against the "use of money" principle, case law, published Service position, and the Code, as explicated in your memorandum.

In Avon Products, Inc. v. United States, 588 F.2d 342 (2d. Cir. 1978), the Second Circuit considered the question of when interest begins to run on a deficiency if a taxpayer has an overpayment shown on its return credited to the next year's estimated tax before the deficiency is determined. On March 15, the taxpayer had filed a Form 7004 and paid one-half of the amount of the estimated tax due. On June 15, the taxpayer paid the remainder and received a further extension to file. On September 15, the taxpayer filed its return and elected to credit the overpayment to the next year's estimated tax. On subsequent audit, a deficiency was determined. The Second Circuit interpreted I.R.C. § 6601(a) to mean that interest could only be charged when a tax becomes both due and unpaid. Although the tax was due on March 15, it did not become unpaid until September 15 when, as a result of the credit against estimated tax, the Government was deprived of the use of the money as a payment of the original year's tax.

In Avon Products, Inc. v. United States, AOD CC-1981-193 (December 23, 1981), the Service adopted the statutory construction articulated in the Second Circuit's opinion. It is now Service position that the starting date of underpayment interest is the date on which taxes are both due and unpaid. Rev. Rul. 88-98, supra, provides that in the case of a refund made without interest under I.R.C. § 6611(e), the date under which the tax is both due and unpaid is the date when the amount in question is refunded, even when that date is subsequent to the date of the claim for refund. See also Reconsideration of Rev. Rul. 83-112, GCM 39772, I-321-84 (April 12, 1985); TAM 88-38-001 (March 7, 1988).

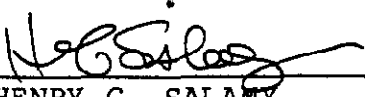
This same principle is also reflected in I.R.C. § 6602. The section concerns interest on an erroneous refund recoverable by suit and provides that underpayment interest runs from the payment date of the refund, i.e., again, the date on which the tax has become both due and unpaid.

CONCLUSION

Interest runs from [REDACTED], in regard to the \$ [REDACTED] underpayment, as the Government had use of the money from [REDACTED] to that date. Any contrary provision in the Service Center Manual concerning computation of interest is in conflict with this conclusion. We will bring this matter to the attention of the Assistant Commissioner (Taxpayer Services and Returns Processing) after you have had the opportunity to discuss the issue with your Service Center personnel.

If you have any question or need further information, please contact Craig R. Gilbert at FTS 566-3305.

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Enclosures:
AOD 1626
GCM 39772
TAM 88-38-001